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CITATIONS

659235—45——1

In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 156

LONGHORN PORTLAND CEMENT COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

SAN ANTONIO PORTLAND CEMENT COMPANY,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 38–50) are reported at 3 T. C. 310. The opinion of the Circuit Court of Appeals (R. 104–106) is reported at 148 F. 2d 276.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on March 27, 1945. (R. 106–107.) The petition for a writ of certiorari was filed June 22, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the $50,000 each taxpayer paid in 1939 in compromise of an antitrust suit brought against them by the State of Texas constituted ordinary and necessary expenses incurred in carrying on trade or business, deductible from gross income under Section 23 (a) (1) (A) of the Internal Revenue Code, as amended.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. [As amended by Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798.]
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—
>
> (1) *Trade or business expenses.*—
>
> (A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.
>
> (26 U. S. C. Sec. 23.)

STATEMENT

The Commissioner determined deficiencies in 1939 income tax and excess profits tax against taxpayer Longhorn Portland Cement Company and in 1939 income tax against taxpayer San Antonio Portland Cement Company. (R. 38.) The deficiencies resulted principally from the disallowance as deductions from gross income of (1) the $50,000 paid by each taxpayer in compromise of an antitrust suit brought against both taxpayers by the State of Texas and (2) attorneys' fees and legal expenses paid by each taxpayer as an incident to that proceeding. (R. 17, 34.) Taxpayers each filed a petition for review by the Tax Court contesting the disallowance of these deductions (R. 6–13, 22–30) and the two cases were consolidated (R. 38). The Tax Court held that the deductions were properly taken under Section 23 (a) (1) (A) of the Internal Revenue Code, as amended, as ordinary and necessary business expenses. (R. 45–50.) The Commissioner appealed from this holding in so far as it related to the payments in compromise of the antitrust proceeding. (R. 53–58, 63–67.) On appeal, the Circuit Court of Appeals reversed the Tax Court, holding that the compromise sums are not deductible because they were paid to the State of Texas as statutory penalties. (R. 104–106.)

The pertinent facts, as found by the Tax Court (R. 39–45), may be summarized as follows:

Taxpayers are corporations organized under the laws of Texas. Prior, subsequent to, and during the taxable year they were engaged in the manufacture and sale of cement, each having gross sales for 1939 of approximately $2,000,000. Their income and excess profits tax returns for the taxable year were filed with the Collector of Internal Revenue for the First District of Texas at Austin. (R. 39.)

On March 7, 1938, the State of Texas filed a suit, captioned *State of Texas* v. *Lone Star Cement Corporation, et al.*, in which the six cement companies then operating in Texas including the two taxpayers, were made defendants. The State's petition alleged violations of the anti-trust laws of Texas and sought recovery of penalties, forfeiture of charters or rights to do business in Texas, as the case might be, establishment and foreclosure of alleged liens, and injunctive relief against alleged conspiracies and agreements. (R. 43.) On November 12, 1938, the State filed an amended petition, continuing the suit against the four major companies but omitting taxpayers therefrom. After the filing of the amended petition, evidence was taken. The record was voluminous, consisting of over 6,000 pages of stenographic record and over 3,000 pages of exhibits. (R. 43.)

Prior to October 4, 1939, an agreement to compromise this suit was negotiated between the four remaining defendants and the attorney general, but the defendants insisted that they should not be bound by injunctions unless their competitors were also bound, on account of the adverse effect upon their business unless this was done. A suit, entitled *State of Texas* v. *San Antonio Portland Cement Company, et al.,* was thereupon filed by the State against taxpayers, but they refused to agree to any compromise. On October 4, 1939, an interlocutory decree was entered in the previous suit, which provided for injunctive relief against the four defendants and for the payment of $400,000 by them to the State; but the interlocutory decree also provided that no final decree should be entered awarding injunctive relief unless similar relief in part was obtained by the State against taxpayers and the Gulf Portland Cement Company. (R. 39, 43.)

The Gulf Portland Cement Company was subsequently made a party defendant in the suit which had been instituted against the taxpayers. (R. 44.) In its petition in this suit the State alleged that the defendants had violated the antitrust laws of the State of Texas in various respects set out in great detail and sought to recover statutory penalties of from $50 to $1,500 per day from January 1, 1930, to the date of filing suit, a judgment canceling and forfeiting taxpayers'

charters, a judgment establishing and foreclosing a statutory lien for the penalties upon the defendants' property, and a judgment enjoining and restraining each defendant from carrying out alleged agreements, conspiracies, trusts, and combinations and for other general and special relief. The answers of each taxpayer to this suit consisted of a general demurrer, a general denial, and a special denial that any acts, methods, or practices used in its business were a result of, or pursuant to, any agreement or for any unlawful purpose. No evidence was ever taken. (R. 39–40.)

Taxpayers' officers and directors were advised by their respective counsel that they had a good defense to the suit, but they were induced to and did compromise the suit in 1939, with the result that each paid the State of Texas $50,000. (R. 39, 40.) The compromise was entered into by taxpayers because of the following considerations (R. 40):

> (a) From the advice and information given them by their attorneys they became convinced that it would cost less to so settle than the expense of carrying the litigation to its end, even though successful.
>
> (b) Disruption of their respective businesses would result from the attendance of officers at hearings for the taking of evidence and a long trial of the case.
>
> (c) Unfavorable publicity would result from the newspaper reports of the trial,

which would have a damaging effect upon their businesses.

(d) The injunctive relief sought by the state would not prevent them from carrying on business according to the prices charged and practices pursued so long as they did not act pursuant to any agreement with one another, or with any other competitor, and they contended that they had not made or joined in any agreement as to the conduct of their businesses.

Judgment as a result of the compromise was rendered on December 15, 1939, and specifically recited in detail the agreement of the parties.[1] (R. 40.) The compromise agreement stated, among other things, that the defendants severally denied that their practices were the result of any agreement, express or implied, or were followed for any unlawful purpose, and also provided that (R. 42):

> This agreement is made by the parties hereto solely and only for the purpose of compr[om]ising and settling the matters

[1] Original Exhibit E, which taxpayers have not had forwarded to this Court, shows that the compromise agreement, after providing for payment of the compromise sums, set out at length the different things which the defendants were to be enjoined from doing. These included a provision against following, except by independent action, any code, compendium or agreement theretofore or thereafter adopted or promulgated by the Cement Institute and an injunction against taxpayers' execution of the statements they had made to their Texas trade concerning their selling policy.

> involved in this suit, by and between the State of Texas, as plaintiff, and the defendants herein named, and it is expressly understood and agreed as a condition hereof, that neither this agreement nor the judgment to be entered thereon, nor any clause or provision of said agreement or judgment, shall constitute or be construed to be an admission or estoppel as against the various defendants herein as evidencing or indicating in any degree an admission of truth or correctness of the allegations in plaintiff's petitions contained in whole or in part.

After reciting the provisions of the agreement, the judgment provided (R. 41):

> And it appearing to the Court that said agreement is proper and in keeping with the law in such cases made and provided, and that same should be approved, and that final judgment be entered in keeping therewith, it is:
>
> FIRST
>
> THEREFORE ORDERED, ADJUDGED AND DECREED that the agreement heretofore entered into between the parties to this cause be and the same is hereby in all things approved.
>
> SECOND
>
> IT IS FURTHER ORDERED, ADJUDGED AND DECREED that plaintiff, the State of Texas, have and recover of and from the defendants, San Antonio Portland Cement Company

and Longhorn Portland Cement Company, jointly and severally, the sum of One Hundred Thousand ($100,000.00) Dollars in full satisfaction of all claims of the State of Texas for penalties for the alleged violations of law set out in Plaintiff's Original Petition, and in full satisfaction of all expenses of the Attorney General in investigating, instituting and preparing this cause for trial; and all costs of suit are hereby adjudged against the defendants, San Antonio Portland Cement Company and Longhorn Portland Cement Company, jointly and severally, but plaintiff shall not recover of and from the Gulf Portland Cement Company any sum of money whatsoever, nor shall any costs of suit be adjudged against defendant Gulf Portland Cement Company.

THIRD

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the Clerk of this Court shall issue to each of the defendants in this cause, including the Gulf Portland Cement Company, a writ of injunction in full conformity with the provisions of said agreement, and that no bond shall be required of plaintiff.

Pursuant to this judgment, the District Court of Travis County issued a permanent injunction against taxpayers and the Gulf Portland Cement Company in conformity with the compromise agreement. (R. 41–42.)

On the basis of these facts, the Tax Court found as a fact that the amounts taxpayers paid in compromise of the suit brought against them by the State of Texas were ordinary and necessary expenses paid or incurred in the carrying on of a trade or business. (R. 44–45.)

ARGUMENT

The decision of the court below was based upon the proposition of law that sums paid pursuant to a compromise judgment in a suit for statutory penalties, in satisfaction of the State's claim, are paid as penalties and are not deductible as "ordinary and necessary business expenses" under Section 23 (a) (1) (A) of the Internal Revenue Code. The validity of this proposition would present an important question of Federal law if the answer were in doubt; but we submit that the decision below was clearly right and in accord with previous decisions and that no occasion is presented for the issuance of a writ of certiorari. There is no conflict of decisions among circuit courts of appeals. Moreover, the taxpayers concede that if sums paid pursuant to a compromise judgment are in fact paid as penalties, they are not deductible. It is argued merely that in this case the Tax Court found they were not so paid and that the failure of the Circuit Court of Appeals to give effect to this finding was a disregard of the principle of *Dobson* v. *Commissioner,* 320

U. S. 489. We think, however, that the doctrine of the *Dobson* case was correctly applied.

The rule is undoubted (R. 48; Pet. Br. 13) that where a taxpayer has incurred a fine or penalty for violation of a Federal or a state statute he is not permitted a tax deduction for its payment. *Commissioner* v. *Heininger,* 320 U. S. 467, 473; *Helvering* v. *Superior Wines & Liquors,* 134 F. 2d 373 (C. C. A. 8th); *United States* v. *Jaffray,* 97 F. 2d 488 (C. C. A. 8th), affirmed on other grounds, *sub nom. United States* v. *Bertelsen & Petersen Co.,* 306 U. S. 276; *Standard Oil Co.* v. *Commissioner,* 129 F. 2d 363 (C. C. A. 7th), certiorari denied, 317 U. S. 688; *Chicago, R. I. & P. Ry. Co.* v. *Commissioner,* 47 F. 2d 990 (C. C. A. 7th), certiorari denied, 284 U. S. 618; *Tunnel R. R.* v. *Commissioner,* 61 F. 2d 166 (C. C. A. 8th), certiorari denied, 288 U. S. 604; *Great Northern Ry. Co.* v. *Commissioner,* 40 F. 2d 372 (C. C. A. 8th), certiorari denied, 282 U. S. 855; *Burroughs Bldg. Material Co.* v. *Commissioner,* 47 F. 2d 178 (C. C. A. 2d); see also Note, 54 Harv. L. Rev. 852 (1941); 4 Mertens, Law of Federal Income Taxation, Sec. 25.35–25.37, 25.102–25.105. The reason for the rule is that to allow the deduction would confer a tax advantage which mitigated the penalty and to that extent to frustrate the purpose of the legislation imposing it. *Commissioner* v. *Heininger, loc. cit. supra; Burroughs Building Material Co.* v. *Commissioner,*

supra; Great Northern Ry. Co. v. *Commissioner, supra.* Clearly this reason extends to payments resulting from the compromise of penalty suits, at least where judgment is entered; for a compromise settlement followed by judgment, not less than a judgment imposing a penalty after a trial upon the merits, represents a sanction authorized by law in order to effectuate the statutory purpose. *United States* v. *Chouteau,* 102 U. S. 603, 611. A civil action to recover penalties is, of course, in the same category as a criminal prosecution for many purposes, *United States* v. *La Franca,* 282 U. S. 568; *United States* v. *Chouteau, supra,* and this has been held specifically with reference to the Texas antitrust act. See *Waters-Pierce Oil Co.* v. *State of Texas,* 48 Tex. Civ. App. 162, writ of error refused, 103 Tex. 676, affirmed, 212 U. S. 86, in which the Court of Civil Appeals stated that "the penalties prescribed were intended as punishment" (48 Tex. Civ. App. at p. 181).

Although it is true in this case, as the Tax Court stated (R. 50), that "the state is in no position under the judgment entered to say that petitioners were convicted of any violations of its antitrust statutes", it is equally true that the State of Texas deemed the evidence of illegal conduct on the part of the taxpayers to be sufficiently weighty to justify the institution of suit; that the taxpayers' competitors were unwilling to con-

tinue their businesses subject to an injunction unless the taxpayers were also enjoined from illegal conduct (see *supra*, p. 5); and that the taxpayers agreed to joint and several liability to pay $100,000 to settle the suit. These factors do not yield to the taxpayers' stipulation in the compromise agreement against admission of guilt of the illegal practices charged; for that provision of the agreement has no bearing upon the "sharply defined" policies (*Commissioner* v. *Heininger, loc. cit. supra*) lying behind the State's suit and the resulting judgment. Indeed, as the Tax Court found (R. 48–49), the judgment in the anti-trust suit against the taxpayers specified that the State of Texas have and recover $100,000 from them "in full satisfaction of all claims of the State * * * for penalties for the alleged violations of law set out in Plaintiff's Original Petition * * *."[2] The purpose of this judgment requires the protection against impairment by operation of the tax laws which this Court recognized as necessary in the *Heininger* case.

The decisions in *Helvering* v. *Superior Wines and Liquors*, 134 F. 2d 373 (C. C. A. 8th) and

[2] The judgment also stated that the $100,000 was "in full satisfaction of all expenses of the Attorney General in investigating, instituting and preparing this cause for trial." (R. 49.) Tex. Rev. Stat. (Vernon, 1939), Art. 7436, provides for payment of a percentage of the penalties collected in an antitrust action to the district or county attorney as fees for representing the State under the direction of the Attorney General.

United States v. *Jaffray,* 97 F. 2d 488 (C. C. A. 8th), affirmed on other grounds *sub nom. United States* v. *Bertelsen and Petersen Co.,* 306 U. S. 276, involving compromise payments in settlement of penalties, support this view and were followed in the court below (R. 106). They may not be distinguished from the instant case on the ground asserted by taxpayers (Br. 15–16), that they involved the "established fact of a violation" (Br. 16), whereas in the present case the compromise judgment negatived any admission of guilt; for the considerations to which we have adverted are of over-riding significance. *Standard Oil Co.* v. *Commissioner,* 129 F. 2d 363 (C. C. A. 7th), certiorari denied, 317 U. S. 688, involved the deductibility of a payment in settlement of an action for conversion of the Government's property. It was necessary to establish that the conversion had been with guilty knowledge, since payments in satisfaction of tort liability are otherwise deductible. Guilty knowledge having been found by the Board of Tax Appeals, the payment was deemed to result from a tort which was "also violative of the criminal statutes" and which, like conviction of an offense, could "not furnish the basis of deduction" (129 F. 2d at p. 371).

As against these considerations, the view of the Tax Court (R. 49–50) that the tax significance of payment of a compromise judgment for penalties may be determined as a question of fact in each case, turning upon "practical aspects that con-

fronted" the taxpayer, is, we submit, inadmissible. The Tax Court recognized (R. 49) that "if unexplained" the judgment of the Texas court "would weigh heavily against" the taxpayers. As the Circuit Court of Appeals correctly held (R. 106), that judgment speaks for itself and may not be explained away; the claimed deduction "was paid as a penalty" pursuant to it, regardless of taxpayers' intention or of collateral circumstances. Tax consequences are determined by the nature of transactions upon which they turn and not ordinarily upon the motives or ideas of taxpayers with regard to their acts. Cf. *Whitehead* v. *Commissioner,* 148 F. 2d 718, 720 (C. C. A. 4th). This is especially true when the transaction is with a sovereign. The decision of the Tax Court was properly reversed for error of law. See *Trust of Bingham* v. *Commissioner,* No. 932, October Term, 1944, decided by this Court June 4, 1945. We think, therefore, it would have been of no consequence if the Tax Court had, as petitioner asserts, made a "finding" that the amount was not a penalty. It may be noted that the court made no such finding but, rather, held that the absence of an admission of guilt meant that the tax consequences of allowing the deduction would not frustrate the public policies of the State of Texas. (R. 50.) This, however, was not a determination to which the principle of the *Dobson* case accords finality.

The policy which taxpayers cite (Br. 19–21), favoring compromise settlement of litigation, does

not go to the length of requiring that tax inducements be offered to encourage voluntary partial payment of statutory penalties with part of the resulting burden transferred to the Federal Government. Hence it offers no argument against the correctness of the decision below. In other situations the policy of encouraging compromise settlement of lawsuits has not been regarded as affording a justification for conferring a tax advantage because a suit or claim was settled for less than the amount sought. See *United States* v. *Safety Car Heating Co.*, 297 U. S. 88, 99–100; *Hort* v. *Commissioner*, 313 U. S. 28; cf. *Lyeth* v. *Hoey*, 305 U. S. 188. Here the allowance of the tax benefit would fly in face of the reason for the nondeductibility of penalty payments, discussed above. And this would be true with respect to penalties for violation of the wartime measures mentioned by taxpayers (Br. 17–18),[3] equally with penalties under earlier laws.

[3] Section 4001.10 of the Regulations of the Economic Stabilization Director, issued October 27, 1942 (7 Fed. Reg. 8748), as amended November 30, 1942 (7 Fed. Reg. 10024), implementing the Emergency Price Control Act, c. 26, 56 Stat. 23, and made applicable also to Regulations No. 4 of the War Manpower Commission (Section 904.6 of Regulations No. 4 of the Chairman of the War Manpower Commission, effective April 18, 1943, 8 Fed. Reg. 5137), provides that wage and salary payments made in violation of the regulations may not be deducted as business expenses for income tax purposes. No problem of the deductibility of sums paid in the compromise settlement of claims seems likely to arise under this provision, which deals wholly with the tax consequence of certain payments actually made in the course of

CONCLUSION

The decision below is correct and involves no conflict of decisions or important, unsettled question of law. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted.

HUGH B. COX,
Acting Solicitor General.
SAMUEL O. CLARK, Jr.,
Assistant Attorney General.
SEWALL KEY,
HELEN R. CARLOSS,
MELVA M. GRANEY,
Special Assistants to the Attorney General.

JULY 1945.

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business, in the absence of any penal proceeding. Nondeductibility is itself one of the prescribed consequences. Insofar as penalty payments or payments in compromise of penalty actions may be made under this and other statutes and regulations, the principle of nondeductibility clearly applies.

U. S. GOVERNMENT PRINTING OFFICE: 1945